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Tax Incentives for Empowerment Zones and Other Distressed Communities



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Introduction

This publication is for business owners who want to find out whether they qualify for certain tax incentives. These incentives are intended to help empowerment zones, enterprise communities, and other distressed communities. A distressed community is any area whose poverty rate or other conditions cause any of these tax incentives to apply. The requirements for each tax incentive are different. The following paragraphs will help guide you in using this publication.

To find out whether your area has been designated as an empowerment zone or enterprise community, read the first section, *Empowerment Zones and Enterprise Communities*.

If you know that your area has been designated as an empowerment zone or enterprise community, skip the first section and begin by reading the first few paragraphs of each section of the publication. Then, read the details of the sections that apply to you.

If you know that your area has not been designated as a zone or community, you should still read the first few paragraphs of each section. Some of these incentives are available in distressed communities that have not been designated as either empowerment zones or enterprise communities. Read the details of the sections that apply to you.

Useful Items

You may want to see:

Publication

- ☐ 946 How To Depreciate Property

Form (and instructions)

- ☐ 5884 Work Opportunity Credit
- ☐ 8844 Empowerment Zone Employment Credit
- ☐ 8850 Pre-Screening Notice and Certification Request for the Work Opportunity and Welfare-to-Work Credits
- ☐ 8861 Welfare-to-Work Credit

Empowerment Zones and Enterprise Communities

The following sections describe current and planned designations of empowerment zones and enterprise communities. These designations will remain in effect for up to 10 years.

Urban designations effective December 21, 1994.

The Secretary of Housing and Urban Development (HUD) has designated 65 urban enterprise communities. The Secretary has also designated parts of the following cities as urban empowerment zones.

- 1) Atlanta, GA (9.29 square miles).
- 2) Baltimore, MD (6.8 square miles).
- 3) Chicago, IL (14.33 square miles).
- 4) Detroit, MI (18.3 square miles).
- 5) New York City, NY (the Bronx and Manhattan; 7.6 square miles).
- 6) Philadelphia, PA/Camden, NJ (4.4 square miles).

Rural designations effective December 21, 1994.

The Secretary of Agriculture (USDA) has designated 30 rural enterprise communities. The Secretary has also designated the following rural empowerment zones.

- 1) The Kentucky Highlands (part of Wayne and all of Clinton and Jackson counties).
- 2) Mid-Delta, Mississippi (parts of Bolivar, Holmes, Humphreys, Leflore, Sunflower, and Washington counties).
- 3) Rio Grande Valley, Texas (parts of Cameron, Hidalgo, Starr, and Willacy counties).

District of Columbia Enterprise Zone (DC Zone).

Effective January 1, 1998, parts of Washington, D.C. are treated as an empowerment zone. This treatment will remain in effect until the end of 2002.

Designations to be effective before January 1, 1999.

Before January 1, 1999:

- 1) HUD may designate 15 additional urban empowerment zones, and
- 2) USDA may designate 5 additional rural empowerment zones.

Designations effective January 1, 2000. HUD has designated parts of the following cities as urban empowerment zones.

- 1) Cleveland, OH.
- 2) Los Angeles, CA.



More information. For more information, call HUD at 1-800-998-9999, or USDA at 1-800-645-4712.



Or you can find out whether your area has been designated as an empowerment zone or an enterprise community by using the Internet address www.ezec.gov.

Empowerment Zone Employment Credit

The empowerment zone employment credit provides businesses with an incentive to hire individuals who both live and work in an empowerment zone. You can claim the credit if you pay or incur "qualified zone wages" to "qualified zone employees."



You cannot claim this credit for a business you will operate in one of the 20 new empowerment zones to be designated before January 1, 1999.

Qualified zone employee. A qualified zone employee is any employee who:

- 1) Performs substantially all of his or her services for you within an empowerment zone in your trade or business, and
- 2) While performing those services, has his or her main home within that empowerment zone (or within the District of Columbia, for services performed within the DC Zone).

Both full-time and part-time employees may qualify.

Nonqualified employees. The following individuals are not qualified zone employees.

- 1) An individual you employ for less than 90 days. However, this 90-day requirement does not apply if:
 - a) You terminate the employee because of misconduct as determined under the applicable state unemployment compensation law, or
 - b) The employee becomes disabled before the 90th day. However, if the disability ends before the 90th day, you must offer to reemploy the former employee.
- 2) Certain related taxpayers.
- 3) Any 5% owner.
- 4) An individual you employ at any:
 - a) Private or commercial golf course,

- b) Country club,
 - c) Massage parlor,
 - d) Hot tub facility,
 - e) Suntan facility,
 - f) Racetrack, or other facility used for gambling, or
 - g) Store whose principal business is the sale of alcoholic beverages for off-premise consumption.
- 5) Any individual you employ in a farming trade or business if, at the close of the tax year, the sum of the following amounts is more than \$500,000.
- a) The larger of the unadjusted bases or fair market value of the farm assets you own.
 - b) The value of the farm assets you lease.

Qualified zone wages. Qualified zone wages are any wages you pay or incur for services performed by an employee while the employee is a qualified zone employee (defined earlier). Wages are generally defined as those wages subject to the Federal Unemployment Tax Act without regard to the dollar limit.

Also treat as qualified zone wages certain training and educational expenses you pay or incur on behalf of a qualified zone employee.

Effect of welfare-to-work or work opportunity credit. Qualified zone wages do not include any amount you take into account in figuring the welfare-to-work credit or the work opportunity credit. Reduce the \$15,000 maximum qualified zone wages for each qualified zone employee by the amount of wages you use to figure either of those credits for that employee.

Amount of credit. The following tables show the rate you apply to the qualified zone wages you pay or incur to qualified zone employees during each calendar year listed. The tables also show the maximum credit you can claim for each qualified zone employee.

Table 1. Rate and Maximum Credit for Zone Designations Effective December 21, 1994

Year	Rate	Maximum Qualified Zone Wages	Maximum Credit
1994 - 2001	20%	\$15,000	\$3,000
2002	15%	15,000	2,250
2003	10%	15,000	1,500
2004	5%	15,000	750

For the District of Columbia Enterprise Zone, the rate is 20% and the maximum credit is \$3,000 until the end of 2002.

Table 2. Rate and Maximum Credit for the Zones in Cleveland and Los Angeles

Year	Rate	Maximum Qualified Zone Wages	Maximum Credit
2000 - 2004	20%	\$15,000	\$3,000
2005	15%	15,000	2,250
2006	10%	15,000	1,500
2007	5%	15,000	750

Claiming the credit. Use *Form 8844, Empowerment Zone Employment Credit*, to claim this credit. Although the empowerment zone employment credit is a component of the general business credit, a special tax liability limit applies to this credit. Therefore, you figure the credit separately and never carry it to *Form 3800, General Business Credit*.

Effect on salary and wage deduction. In general, you must reduce the deduction on your income tax return for salaries and wages and certain educational and training costs by the amount of your empowerment zone employment credit.

More information. For more information about the empowerment zone employment credit, see *Form 8844*.

Increased Section 179 Deduction

You may be able to claim an increased section 179 deduction if your business qualifies as an "enterprise zone business." The increase can be as much as \$20,000. This increased section 179 deduction applies to "qualified zone property" you place in service in an empowerment zone.



CAUTION You cannot claim this increased deduction for a business you operate in an enterprise community.

Enterprise zone business. For purposes of this incentive, a corporation, partnership, or sole proprietorship is an enterprise zone business if all of the following statements are true for the tax year.

- 1) Every trade or business of the corporation or partnership is the active conduct of a qualified business (defined later) within an empowerment zone. (This rule does not apply to a sole proprietorship.)
- 2) At least 50% (80% for tax years beginning before August 5, 1997) of its total gross income is from the active conduct of a qualified business within a zone.
- 3) A substantial part of the use of its tangible property is within a zone. (For tax years beginning before August 5, 1997, at least 85% of the use of its tangible property must be within a zone.)
- 4) A substantial part of its intangible property is used in the active conduct of the business. (For tax years beginning before August 5, 1997, at least 85% of

its intangible property must be used in, and exclusively related to, the active conduct of the business.)

- 5) A substantial part of the employees' services are performed within a zone. (For tax years beginning before August 5, 1997, at least 85% of the employees' services must be performed within a zone.)
- 6) At least 35% of the employees are residents of an empowerment zone. (This rule does not apply to businesses in the District of Columbia Enterprise Zone.)
- 7) Less than 5% of the average of the total unadjusted bases of the property owned by the business is from:
 - a) Certain financial property, or
 - b) Collectibles not held primarily for sale to customers.

For a sole proprietorship, the term "employee" in (5) and (6) includes the proprietor.

Qualified business. A qualified business is generally any trade or business except one that consists primarily of the development or holding of intangibles for sale or license.

However, the rental to others of real property located in an empowerment zone is a qualified business only if the property is not residential rental property and at least 50% of the gross rental income from the real property is from enterprise zone businesses.

The rental to others of tangible personal property is a qualified business only if at least 50% of the rentals of the property are to enterprise zone businesses or zone residents. (For tax years beginning before August 5, 1997, at least 85% of the rentals of the property must be to enterprise zone businesses or zone residents.)

Also, a qualified business does not include any business listed earlier in item (4) or (5) under *Non-qualified employees in the Empowerment Zone Employment Credit* section.

Qualified zone property. For purposes of this incentive, depreciable tangible property is qualified zone property if all of the following are true.

- 1) You acquired the property after the zone designation is in effect.
- 2) You did not acquire the property from a related person or member of a controlled group of which you are a member.
- 3) Your basis in the property is not determined either by its adjusted basis in the hands of the person from whom you acquired it or under the stepped-up basis rules for property acquired from a decedent.
- 4) You were the first person to use the property in an empowerment zone.

- 5) At least 85% of the property's use is in an empowerment zone and in the active conduct of a qualified trade or business in the zone.

Buildings are qualified zone property but do not qualify for the section 179 deduction. Used property may be qualified zone property if it has not previously been used within an empowerment zone.

Special rule for substantially renovated property. Property will be treated as having met requirements (1) and (4) above if you substantially renovate the property. Property will be treated as substantially renovated if, during any 24-month period beginning after the zone designation takes effect, your additions to the basis of the property are more than the greater of the following amounts.

- 1) 100% of the adjusted basis of the property at the beginning of the 24-month period.
- 2) \$5,000.

Property used in developable parcels. Qualified zone property does not include certain property used in some developable noncontiguous parcels. This rule applies to property to which all of the following apply.

- 1) Substantially all the use of the property is in a noncontiguous parcel.
- 2) The parcel is one that:
 - a) Could be developed for commercial or industrial purposes, and
 - b) Was included in one of the 20 new empowerment zones to be designated before January 1, 1999, under an exception for developable noncontiguous parcels that allowed it to be excluded from the poverty rate requirement.

Section 179 deduction. Section 179 of the Internal Revenue Code allows you to *elect* to deduct all or part of the cost of certain qualifying property in the year you place it in service. You can do this instead of recovering the cost by taking depreciation deductions over a specified recovery period. There are limits, however, on the amount you can deduct in a tax year. These limits are increased for certain qualified zone property placed in service by an enterprise zone business.

Maximum dollar limit. The total cost of section 179 property that you can elect to deduct for a tax year generally cannot be more than the maximum section 179 dollar limit. However, if you place qualified zone property in service during the year this maximum dollar limit is increased by the smaller of:

- 1) \$20,000, or
- 2) The cost of section 179 property that is qualified zone property you placed in service during the year.

The following table shows these maximum dollar limits.

Table 3. Maximum Dollar Limits

For Tax Years Beginning In	Maximum Section 179 Dollar Limit	Maximum Dollar Limit With Qualified Zone Property
1997	\$18,000	\$38,000
1998	18,500	38,500
1999	19,000	39,000
2000	20,000	40,000
2001 - 2002	24,000	44,000
Years after 2002	25,000	45,000

These maximum dollar limits are reduced if you go over the investment limit (discussed next) in any tax year.

Investment limit. For each dollar of your business cost over \$200,000 for section 179 property placed in service in a tax year, reduce the maximum dollar limit by one dollar (but not below zero). However, take only one-half of the cost of section 179 property that is qualified zone property into account when reducing the maximum dollar limit.

Example. In 1997, your enterprise zone business placed in service qualified zone property costing \$420,000. Your maximum dollar limit is \$38,000. Because all of this property is qualified zone property, only \$210,000 (50% of this cost) is used to figure the investment limit. Because \$210,000 is \$10,000 more than \$200,000, you must reduce the maximum dollar limit of \$38,000 by \$10,000. If your taxable income is at least \$28,000, you can claim a \$28,000 section 179 deduction for 1997.

Recapture. The recapture rules of section 179 apply when qualified zone property is no longer used in an empowerment zone by an enterprise zone business.

More information. For more information about the section 179 deduction, see Publication 946, *How To Depreciate Property*.

Tax-Exempt Bond Financing

State or local governments can issue enterprise zone facility bonds (a type of exempt facility tax-exempt bond) to raise funds to provide an "enterprise zone business" with "qualified zone property." At least 95% of the net proceeds from the bond issue must be used to finance:

- 1) Qualified zone property whose principal user is an enterprise zone business, and
- 2) Certain land used for a related purpose (for example, land where the business is located and a parking lot for customers and employees).

Tax-exempt bonds generally have lower interest rates than conventional financing.



TIP Contact the appropriate state or local government agency to find out if this type of financing is available in your empowerment zone or enterprise community.

Enterprise zone business. For purposes of this incentive, a corporation, partnership, or sole proprietorship is generally an enterprise zone business if all of the following statements are true for the tax year.

- 1) Every trade or business of the corporation or partnership is the active conduct of a qualified business (defined later) within an empowerment zone or an enterprise community. (This rule does not apply to a sole proprietorship.)
- 2) At least 50% (80% for bonds issued before August 6, 1997) of its total gross income is from the active conduct of a qualified business within a zone or community.
- 3) A substantial part of the use of its tangible property is within a zone or community. (For bonds issued before August 6, 1997, at least 85% of the use of its tangible property must be within a zone or community.)
- 4) A substantial part of its intangible property is used in the active conduct of the business. (For bonds issued before August 6, 1997, at least 85% of its intangible property must be used in, and exclusively related to, the active conduct of the business.)
- 5) A substantial part of the employees' services are performed within a zone or community. (For bonds issued before August 6, 1997, at least 85% of the employees' services must be performed within a zone or community.)
- 6) At least 35% of the employees are residents of an empowerment zone or enterprise community. (This rule does not apply to businesses in the District of Columbia Enterprise Zone.)
- 7) Less than 5% of the average of the total unadjusted bases of the property owned by the business is from:
 - a) Certain financial property, or
 - b) Collectibles not held primarily for sale to customers.

For a sole proprietorship, the term "employee" in (5) and (6) includes the proprietor. Also, a business located in a zone or community that would qualify if it were separately incorporated is treated as an enterprise zone business. For example, a business that is part of a national chain could qualify, providing it would meet the definition of an enterprise zone business if it were separately incorporated.

Qualified business. A qualified business is generally any trade or business except one that consists primarily of the development or holding of intangibles for sale or license.

However, the rental to others of real property located in an empowerment zone or enterprise community is a qualified business only if the property is not residential rental property and at least 50% of the gross rental income from the real property is from enterprise zone businesses.

The rental to others of tangible personal property is a qualified business only if at least 50% of the rentals of the property are to enterprise zone businesses or

zone or community residents. (For bonds issued before August 6, 1997, at least 85% of the rentals of the property must be to enterprise zone businesses or zone or community residents.)

Also, a qualified business does not include any business listed earlier in item (4) or (5) under *Nonqualified employees in the Empowerment Zone Employment Credit* section.

Relaxed requirements during start-up period. For bonds issued after August 5, 1997, a business will be treated as an enterprise zone business during a start-up period if:

- 1) It is reasonable, at the beginning of the start-up period, to expect the business to be an enterprise zone business by the end of the start-up period, and
- 2) The business makes bona fide efforts to be an enterprise zone business.

The start-up period is the period that ends with the start of the first tax year beginning more than 2 years after the later of:

- 1) The issue date of the bond issue financing the qualified zone property, or
- 2) The date this property is first placed in service (or, if earlier, the date that is 3 years after the issue date).

Reduced requirements after testing period. For bonds issued after August 5, 1997, a business that qualifies as an enterprise zone business at the end of the start-up period must continue to qualify during a testing period that ends 3 tax years after the start-up period ends. After the 3-year testing period, a business will continue to be treated as an enterprise zone business as long as at least 35% of its employees are residents of an empowerment zone or enterprise community. However, this special rule does not apply to:

- 1) Any trade or business that consists primarily of the development or holding of intangibles for sale or license, or
- 2) Any business listed earlier in item (4) or (5) under *Nonqualified employees in the Empowerment Zone Employment Credit* section.

Qualified zone property. For purposes of this incentive, depreciable real or tangible personal property is qualified zone property if all of the following are true.

- 1) You acquired the property after the zone or community designation is in effect.
- 2) You did not acquire the property from a related person or member of a controlled group of which you are a member.
- 3) Your basis in the property is not determined either by its adjusted basis in the hands of the person from whom you acquired it or under the stepped-up basis rules for property acquired from a decedent.
- 4) You were the first person to use the property in an empowerment zone or enterprise community.

- 5) At least 85% of the property's use is in an empowerment zone or enterprise community and in the active conduct of a qualified trade or business in the zone or community.

Used property may be qualified zone property if it has not previously been used within an empowerment zone or enterprise community.

Special rule for substantially renovated property. Property will be treated as having met requirements (1) and (4) above if you substantially renovate the property. Property will be treated as substantially renovated if, during any 24-month period beginning after the zone or community designation takes effect, your additions to the basis of the property are more than the greater of the following amounts.

- 1) 15% (100% for bonds issued before August 6, 1997) of the adjusted basis of the property at the beginning of the 24-month period.
- 2) \$5,000.

Special rule for bonds issued after July 30, 1996. Generally for bonds issued after July 30, 1996, property that you reasonably expect by exercising due diligence to be qualified zone property by an initial testing date will be treated as qualified zone property for the period before that date.

The **initial testing date** is generally the date that is 18 months after the later of:

- 1) The issue date of the bond issue financing the qualified zone property, or
- 2) The date this property is first placed in service (or, if earlier, the date that is 3 years (5 years for certain construction projects) after the issue date).

However, the issuer of the bonds can choose to use any earlier date that comes after the bond issue date as the initial testing date.

Interest not deductible. No deduction will be allowed for interest on any financing provided from a bond if the interest accrues in any year in which:

- 1) Substantially all of the facility that was financed ceases to be used in an empowerment zone or enterprise community, or
- 2) The principal user of the facility ceases to be an enterprise zone business.

This rule does not apply if the use of the facility ceases to qualify because of bankruptcy or the termination or revocation of the designation as an empowerment zone or enterprise community.

In addition, interest will remain deductible if the issuer and principal user try in good faith to meet the requirements and any failure is corrected within a reasonable period after discovery.

More information. For more information, see Internal Revenue Code section 1394 and the regulations under that section.

Environmental Cleanup Cost Deduction

This deduction provides businesses with an incentive to clean up certain sites that are contaminated with hazardous substances. Your business does not have to be in an empowerment zone or enterprise community to qualify for this deduction.

You can **elect** to deduct "qualified environmental cleanup costs" in the tax year you pay or incur the cost. You can do this instead of adding the cost to the basis of your property (and, if the property is depreciable, recovering the cost by taking depreciation deductions over a specified recovery period).

This special tax treatment is generally available for qualified environmental cleanup costs you pay or incur after August 5, 1997, and before January 1, 2001.

Qualified environmental cleanup costs. Qualified environmental cleanup costs are generally costs you pay or incur to abate or control a hazardous substance (as defined by Internal Revenue Code section 198(d)) at a "qualified contaminated site."

Qualified contaminated site. A qualified contaminated site must meet all of the following requirements.

- 1) You hold it for use in a trade or business, for the production of income, or as inventory.
- 2) It is within a "targeted area."
- 3) There has been a release, threat of release, or disposal of a hazardous substance at or on the site.

You must get a statement from the designated state environmental agency that the site meets requirements (2) and (3).

Targeted area. All of the following areas are targeted areas.

- 1) A population census tract (or equivalent county division defined by the Bureau of the Census) with a poverty rate of at least 20%.
- 2) A population census tract with a population of less than 2,000 that meets the following two requirements.
 - a) More than 75% of the tract is zoned for commercial or industrial use.
 - b) The tract has a common border with one or more of the tracts described in (1).
- 3) An empowerment zone.
- 4) Any supplemental empowerment zone designated on December 21, 1994.
- 5) An enterprise community.
- 6) A site included as a brownfields pilot project of the Environmental Protection Agency before February 1, 1997.

Recapture. This deduction may have to be recaptured as ordinary income under section 1245 when you sell or otherwise dispose of the property that would have received an addition to basis if you had not elected this deduction.

More information. For more information about the environmental cleanup cost deduction, see Internal Revenue Code section 198.

Qualified Zone Academy Bonds

Beginning in 1998, state or local governments can issue "qualified zone academy bonds" to raise funds for the use of a "qualified zone academy." Certain banks, insurance companies, and corporations actively engaged in the business of lending money can receive a tax credit as an incentive to hold these bonds.

These bonds are described in this publication because they require a private business contribution.

Qualified zone academy. A qualified zone academy is a public school (or academic program within a public school) at the secondary level or below that meets all of the following requirements.

- 1) It is established by and operated under the supervision of a local education agency (as defined in section 14101 of the Elementary and Secondary Education Act of 1965).
- 2) It is designed in cooperation with private business to improve the academic curriculum, enhance graduation and employment rates, and better prepare students for college and the workforce.
- 3) Its students are subject to the same academic standards and assessments as other students educated by the local education agency.
- 4) Its comprehensive education plan is approved by the local education agency.
- 5) It is located in either an empowerment zone or an enterprise community, or there is a reasonable expectation when the bonds are issued that at least 35% of the school's students (or program's participants) will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

Qualified zone academy bond. A qualified zone academy bond is a bond issued by a state or local government for the area where the qualified zone academy is located. The bond must meet all of the following requirements.

- 1) The issuer:
 - a) Designates the bond issue for the use of a qualified zone academy,
 - b) Has written assurances that the private business contribution requirement will be met, and

- c) Has written approval for the bond issue from the local education agency.
- 2) At least 95% of the proceeds from the bond issue are to be used to do any of the following for the qualified zone academy.
 - a) Rehabilitate or repair its facility.
 - b) Obtain equipment.
 - c) Develop course materials.
 - d) Train teachers and other school personnel.
- 3) The term of each bond does not exceed a maximum term.

Private business contribution requirement. Before qualified zone academy bonds can be issued, the local education agency must obtain written commitments from private entities for qualified contributions with a present value (as of the bond issue date) of not less than 10% of the proceeds of the bond issue.

A qualified contribution is a contribution made with the approval of the local education agency of any property or service from the following list.

- 1) Equipment for use in the qualified zone academy.
- 2) Technical assistance in developing curriculum or in training teachers to promote appropriate market driven technology in the classroom.
- 3) Services of employees as volunteer mentors.
- 4) Internships, field trips, or other educational opportunities outside the academy for students.
- 5) Any other property or service specified by the local education agency.

More information. For more information about qualified zone academy bonds, see Internal Revenue Code section 1397E and the regulations under that section.

Work Opportunity Credit

The work opportunity credit provides businesses with an incentive to hire individuals from groups that have a particularly high unemployment rate or other special employment needs. Your business does not have to be in an empowerment zone or enterprise community to qualify for this credit. You can claim the credit if you pay or incur "qualified wages" during the first year of employment to "members of targeted groups" who begin work after September 1996.



At the time this publication went to print, this credit was set to expire for individuals who begin work after June 1998.

Members of targeted groups. A member of a targeted group is an individual who has been certified by your state employment security agency (SESA) as a:

- 1) Recipient of assistance under Aid to Families with Dependent Children (AFDC) or successor program,
- 2) Veteran,
- 3) Ex-felon,
- 4) High-risk youth,
- 5) Vocational rehabilitation referral,
- 6) Summer youth employee,
- 7) Food stamp recipient, or
- 8) Supplemental security income (SSI) recipient.

Members of each group must meet the requirements explained in the instructions to Form 8850.

State certification required. An individual is not considered a member of a targeted group without SESA certification. To receive certification, submit **Form 8850, Pre-Screening Notice and Certification Request for the Work Opportunity and Welfare-to-Work Credits**, to your SESA.

You must either:

- 1) Receive the certification by the day the individual begins work, or
- 2) Do both of the following:
 - a) Complete Form 8850 by the day you offer the individual a job, and
 - b) Submit the form to your SESA by the 21st day after the individual begins work.

Qualified wages. Qualified wages are generally wages subject to the Federal Unemployment Tax Act (FUTA), but not more than \$6,000 for each employee (\$3,000 for a summer youth employee). If the work performed by the employee during more than half of any pay period qualifies under FUTA as agricultural labor, the first \$6,000 of that employee's wages subject to social security and Medicare taxes are qualified wages. For a special rule that applies to railroad employees, see Internal Revenue Code section 51(h)(1)(B).

Nonqualified wages. See Form 5884 for a complete list of wages that do not qualify for the credit. Some of the most common wages that do not qualify include wages you pay or incur to an employee who:

- 1) Has worked for you for more than 1 year,
- 2) Is your relative or dependent,
- 3) You rehired, if he or she was not a targeted group member when employed earlier, or
- 4) Does not work for you for at least 120 hours.

Amount of credit. The following table shows the rate you apply to the qualified wages you pay or incur to employees who work the number of hours shown. The table also shows the maximum credit you can claim for each qualified employee.

Table 4. Rate and Maximum Credit for Individuals Who Begin Work After September 1997

Hours Worked	Rate	Maximum Qualified Wages	Maximum Credit
At least 400	40%	\$6,000*	\$2,400
Fewer than 400 but at least 120	25%	6,000*	1,500

*\$3,000 for a summer youth employee

Claiming the credit. Use **Form 5884, Work Opportunity Credit**, to claim this credit. You can **elect** to claim this credit any time within 3 years from the due date of your return on either your original return or on an amended return.

Effect on salary and wage deduction. In general, you must reduce the deduction on your income tax return for salaries and wages by the amount of your work opportunity credit.

Effect on empowerment zone employment credit. Wages you use to claim the work opportunity credit cannot be used to figure the empowerment zone employment credit. In addition, they reduce the maximum qualified zone wages you can use to claim the empowerment zone employment credit for an employee who qualifies you for both credits.

Effect of welfare-to-work credit. You cannot claim both the work opportunity credit and the welfare-to-work credit for the same employee during the same tax year.

More information. For more information on the work opportunity credit, see **Form 5884**.

Welfare-to-Work Credit

The welfare-to-work credit provides businesses with an incentive to hire long-term family assistance recipients. Your business does not have to be in an empowerment zone or enterprise community to qualify for this credit. You can claim the credit if you pay or incur "qualified wages" during the first 2 years of employment to a "long-term family assistance recipient" who begins work after December 1997.



At the time this publication went to print, this credit was set to expire for individuals who begin work after April 1999.

Long-term family assistance recipient. A long-term family assistance recipient is an individual who has been certified by your state employment security agency (SESA) as a member of a family that:

- Has received assistance payments from Aid to Families with Dependent Children (AFDC) or a successor program for at least 18 consecutive months ending on the hiring date,
- Receives assistance payments from AFDC or a successor program for any 18 months (whether or not consecutive) beginning after August 5, 1997,

and is hired not more than 2 years after the end of the earliest 18-month period, or

- Stops being eligible after August 5, 1997, for assistance payments because federal or state law limits the maximum period that assistance is payable, and is hired not more than 2 years after that eligibility for assistance ends.

State certification required. An individual is not considered a long-term family assistance recipient without SESA certification. To receive certification, submit **Form 8850, Pre-Screening Notice and Certification Request for the Work Opportunity and Welfare-to-Work Credits**, to your SESA.

You must either:

- Receive the certification by the day the individual begins work, or
- Do both of the following:
 - Complete **Form 8850** by the day you offer the individual a job, and
 - Submit the form to your SESA by the 21st day after the individual begins work.

Qualified wages. Qualified wages are generally wages subject to the Federal Unemployment Tax Act (FUTA) without regard to the dollar limit. If the work performed by the employee during more than half of any pay period qualifies under FUTA as agricultural labor, the first \$10,000 of that employee's wages subject to social security and Medicare taxes are qualified wages. For a special rule that applies to railroad employees, see Internal Revenue Code section 51A(b)(5)(C).

For purposes of this credit, qualified wages also generally include the following amounts paid or incurred by the employer which are normally excludable from the employee's gross income.

- Amounts received for medical care under accident and health plans.
- Employer provided coverage under accident and health plans.
- Amounts excludable under an educational assistance program (or that would be excludable but for the expiration of the program).
- Amounts excludable under a dependent care assistance program.

Nonqualified wages. See **Form 8861** for a complete list of wages that do not qualify for the credit. Some of the most common wages that do not qualify include wages you pay or incur to an employee who:

- Has worked for you for more than 2 years,
- Is your relative or dependent,
- You rehired, if he or she was not a long-term family assistance recipient when employed earlier, or
- Does not either:
 - Work for you for at least 180 days, or
 - Complete at least 400 hours of service.

Amount of credit. The following table shows the rate you apply to the qualified wages you pay or incur during each year of employment. The table also shows the maximum credit you can claim for each qualified employee.

Table 5. Rate and Maximum Credit

Year of Employment	Rate	Maximum Qualified Wages	Maximum Credit
First	35%	\$10,000	\$3,500
Second	50%	10,000	5,000

Claiming the credit. Use **Form 8861, Welfare-to-Work Credit**, to claim this credit. You can **elect** to claim this credit any time within 3 years from the due date of your return on either your original return or on an amended return.

Effect on salary and wage deduction. In general, you must reduce the deduction on your income tax return for salaries and wages by the amount of your welfare-to-work credit.

Effect on empowerment zone employment credit. Wages you use to claim the welfare-to-work credit cannot be used to figure the empowerment zone employment credit. In addition, they reduce the maximum qualified zone wages you can use to claim the empowerment zone employment credit for an employee who qualifies you for both credits.

Effect of work opportunity credit. You cannot claim both the welfare-to-work credit and the work opportunity credit for the same employee during the same tax year.

More information. For more information on the welfare-to-work credit, see Form 8861.

Exclusion of Capital Gains From DC Zone Assets

Beginning in 1998, if you acquire a District of Columbia Enterprise Zone (DC Zone) asset and hold it more than 5 years, you will not have to include any qualified capital gain from its sale or exchange in your gross income. This exclusion applies to an interest in, or property of, certain businesses operating in the District of Columbia.

DC Zone Asset

A DC Zone asset is any of the following.

- DC Zone business stock.
- DC Zone partnership interest.
- DC Zone business property.

DC Zone business stock. DC Zone business stock is any stock in a U.S. corporation that is originally issued after December 31, 1997, if all of the following requirements are met.

- 1) You acquired the stock before January 1, 2003, at its original issue solely in exchange for cash. This

requirement is also met if you acquired the stock from another person in whose hands it was DC Zone business stock.

- 2) The corporation was a DC Zone business (or was being organized as a DC Zone business) at the time the stock was issued.
- 3) The corporation qualified as a DC Zone business during substantially all of your holding period for the stock. This requirement is also met if the corporation ceased to qualify as a DC Zone business after the 5-year period beginning on the date you acquired the stock (but your qualified capital gain will be limited, as explained later).

Redemptions of business stock. Stock will not qualify as DC Zone business stock if the issuing corporation makes certain redemptions of its stock within 2 years before or 2 years after the date the stock was issued. For details, see Internal Revenue Code sections 1400B(b)(2)(B) and 1202(c)(3).

DC Zone partnership interest. A DC Zone partnership interest is any capital or profits interest in a U.S. partnership that is originally issued after December 31, 1997, if all of the following requirements are met.

- 1) You acquired the partnership interest from the partnership before January 1, 2003, in exchange for cash. This requirement is also met if you acquired the partnership interest from another person in whose hands it was a DC Zone partnership interest.
- 2) The partnership was a DC Zone business (or was being organized as a DC Zone business) at the time you acquired the partnership interest.
- 3) The partnership qualified as a DC Zone business during substantially all of your holding period for the partnership interest. This requirement is also met if the partnership ceased to qualify as a DC Zone business after the 5-year period beginning on the date you acquired the partnership interest (but your qualified capital gain will be limited, as explained later).

Redemptions of partnership interest. A partnership interest will not qualify as a DC Zone partnership interest if the partnership makes certain acquisitions of its partnership interests within 2 years before or 2 years after the date the partnership interest was issued. For details, see Internal Revenue Code sections 1400B(b)(3), 1400B(b)(2)(B), and 1202(c)(3).

DC Zone business property. DC Zone business property is tangible property that meets all of the following requirements.

- 1) You acquired the property after December 31, 1997, and before January 1, 2003.
- 2) You did not acquire the property from a related person or member of a controlled group of which you are a member.
- 3) Your basis in the property is not determined either by its adjusted basis in the hands of the person from

whom you acquired it or under the stepped-up basis rules for property acquired from a decedent.

- 4) You were the first person to use the property in the DC Zone. This requirement is also met if you acquired the property from another person in whose hands it was DC Zone business property.
- 5) Substantially all of the use of the property was in your DC Zone business during substantially all of your holding period for that property. This requirement is also met if you stopped using the property in your DC Zone business, or your business ceased to qualify as a DC Zone business, after the 5-year period beginning on the date you acquired the property (but your qualified capital gain will be limited, as explained later).

Special rule for substantially improved buildings.

Buildings (and land on which they are located) will be treated as having met requirements (1) through (4) above if you substantially improved the buildings before January 1, 2003. The buildings will be treated as substantially improved only if, during any 24-month period beginning after December 31, 1997, your additions to the basis of the property are more than the greater of the following amounts.

- 1) 100% of the adjusted basis of the property at the beginning of the 24-month period.
- 2) \$5,000.

DC Zone business. A DC Zone business for purposes of this capital gains exclusion is an enterprise zone business as defined earlier under *Increased Section 179 Deduction*, with the following exceptions.

- The 35% zone resident employee requirement listed in item (6) does not apply.

- The 50% of gross income requirement listed in item (2) is increased to 60%.
- No area other than the DC Zone can be treated as an empowerment zone or enterprise community.

For this purpose, the DC Zone is treated as including all census tracts in the District of Columbia with a poverty rate of 10% or more.

Qualified Capital Gain

Qualified capital gain is any gain recognized on the sale or exchange of a DC Zone asset that is a capital asset or property used in a trade or business as defined in section 1231(b) of the Internal Revenue Code (generally real property or depreciable personal property). But it does not include any of the following gains.

- Gain attributable to periods before January 1, 1998, or after December 31, 2007.
- Section 1245 gain. See chapter 4 in Publication 544, *Sales and Other Dispositions of Assets*.
- Section 1250 gain if section 1250 applied to *all* depreciation rather than the additional depreciation. See chapter 4 in Publication 544.
- Gain attributable to real property or an intangible asset that is not an integral part of a DC Zone business.
- Gain attributable, directly or indirectly, or in whole or in part, to a transaction with a related party. For the definition of a related party, see chapter 2 in Publication 544.

Other rules. Rules similar to certain rules in section 1202 of the Internal Revenue Code apply to interests in pass-through entities, certain tax-free transfers, contributions to capital after the original stock issuance date, and short positions.

How To Get More Information



You can get help from the IRS in several ways.

Free publications and forms. To order free publications and forms, call 1-800-TAX-FORM (1-800-829-3676). You can also write to the IRS Forms Distribution Center nearest you. Check your income tax package for the address. Your local library or post office also may have the items you need.

For a list of free tax publications, order Publication 910, *Guide to Free Tax Services*. It also contains an index of tax topics and related publications and describes other free tax information services available from IRS, including tax education and assistance programs.

If you have access to a personal computer and modem, you also can get many forms and publications electronically. See *Quick and Easy Access to Tax Help and Forms* in your income tax package for details.

Tax questions. You can call the IRS with your tax questions. Check your income tax package or telephone book for the local number, or you can call 1-800-829-1040.

TTY/TDD equipment. If you have access to TTY/TDD equipment, you can call 1-800-829-4059 to ask tax questions or to order forms and publications. See your income tax package for the hours of operation.

Evaluating the quality of our telephone services. To ensure that IRS representatives give accurate, courteous, and professional answers, we evaluate the quality of our "800 number" telephone services in several ways.

- A second IRS representative sometimes monitors live telephone calls. That person only evaluates the IRS assistant and does not keep a record of any taxpayer's name or tax identification number.
- We sometimes record telephone calls to evaluate IRS assistants objectively. We hold these recordings no longer than one week and use them only to measure the quality of assistance.
- We value our customers' opinions. Throughout this year, we will be surveying our customers for their opinions on our service.

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